LOANS AND TAXES IN WAR FINANCE—DISCUSSION

E. T. Miller.—Two phases of Professor Sprague's very able paper invite discussion: the one involves the principles of money, the other the principles of public finance.

The relation of money and credit to prices, the relative importance of the money side and of the goods side in a period of price changes, the relation of particular prices to the price level, and what the constitutents of the money side are—whether standard money or both standard money and credit money or all purchasing media—remain among the unsettled questions of money, though each one of us doubtless has rather positive convictions about them.

Professor Sprague takes the usual position of a quantity theorist with respect to most of these points. Subject to the qualification that the country is not nearing economic exhaustion, any considerable rise in the level of prices in a country engaged in war must be due, he thinks, to an increase in the volume of the purchasing media, and the medium most responsible for the rise in the price level is bank credit in the form of notes and deposits.

It is not my wish to direct undue attention to this phase of the paper, for clearly the main emphasis is upon taxation as a method of war finance. At the same time the avoidance of a rise in prices is one of the principal advantages claimed for taxation over borrowing, and so it is not altogether inappropriate to comment briefly on the theory found in the paper of price changes in a country engaged in war.

In the warring countries today the concern is not with that abstraction the level of prices, but it is with particular prices. The movements which engage attention are those of the prices of coal, gasoline, wheat, sugar, wool, cotton, leather, and many similar particular commodities of vital military and domestic consumption, and not the movements of an index number, which is probably a purposeless general purpose number, and includes whale oil and sassafras, crêpe de Chine and checkers.

The rises in the prices of these particular commodities are not, in my opinion, due principally to changes originating on the side of, or connected with, money and credit, but are to be attributed to changes in the relations between the demand for and supply of the goods themselves. To give an example, it is said that the English trench soldiers require a new woolen uniform every thirty days. This greatly multiplied demand, as compared with the peace demand, cannot be offset by the decreased consumption of woolens by the nonbelligerents. No policy of excessive taxation, therefore, would prevent, we think, that rise of prices which is of most concern in time of war.

Preference for taxation over borrowing as a method of financing a war has received the endorsement of Hume, Adam Smith, Ricardo, Chalmers, and Mill, among the economists and among the statesmen. Gladstone was a distinguished advocate of it in the beginning of the Crimean War, although his advocacy was later in a much modified form. It has been called the English method, but improperly so, because it has never been thoroughly applied in England. As the sole method of financing a war it would be impossible, and before the gigantic expenditures of such a war as is now being waged the proceeds of a confiscatory policy such as is proposed by Professor Sprague would be a mere bagetelle.

In 1913 Dr. Helfferich estimated the national income of Germany at ten billion dollars. Some seven billions of this went to support the imperial, state, and local governments. Some six and a quarter billions was devoted to private consumption, and about two billions was added to the capital fund of the country. As a result of the war there has been an estimated decrease of three and a quarter billions, so that the present national income is only about six and two-thirds billion dollars, and this amount is to be compared with war expenditures at the rate of nearly eight billions a year. In France war costs are estimated at 62 per cent of pre-war national income, and in England they are placed at 49 per cent. In the light of these figures, extensive borrowing would seem to be inescapable. Borrowing in neutral markets as in the markets of allied countries would encourage inflation in those markets and so lead to a rise in prices, and especially would a rise occur when the proceeds of the loan were expended in the lending country's market. Prices in the borrowing country surely would move in sympathy with those in foreign markets.

Should borrowing in the domestic market be confined to preëxisting capital? And if it should, could it be so restricted? Professor Sprague thinks that it should and that it could. His reason why it should is fundamentally a moral one. He would confiscate through the tax agency all additions to income in excess not only of the prewar amount but also of necessary consumption, and for the reason that it is unjust and inequitable that there should be conscription of person and not conscription of income. In this case the appeal to equity is something like the appeal to natural rights. It is a matter largely of individual opinion, and while the proposal may seem equitable to some, it may not to others. When there is conscription of person, who are those who are left at home and what is their lot? Are they—the women and the children, the old, the infirm, and the weak—fit subjects for drastic taxation? Is not increased labor called for from all who are left behind, and are there not also added risks to those who engage in industry? A 100 per cent excess income tax would be unjust, and superimposed as it would have to be upon a tax system extended and raised for purely fiscal reasons, it might be so vexatious and depressing, in the case especially of a protracted war, as to weaken the motive to industry and defeat the main purpose of the financial program, which is to raise funds to carry on the war. Too drastic taxation, in other words, ignores what Professor H. C. Adams calls the "psychological factor" in raising public funds. Furthermore, the problem of assessing and collecting the taxes would be most difficult, and the example of practical socialization of moderate sized and large incomes in time of war would be a Banquo's ghost in time of peace.

The reduction of unnecessary or wasteful consumption is one of the principal arguments for heavy war taxation. Such an argument is more applicable to some countries than to others. In only one of the present warring countries has there been extravagant or riotous consumption to be checked.

Though there is no feasible policy of taxation which can prevent entirely a rise of prices, and while borrowing in the domestic market is inescapable, a union of taxation and of borrowing is desirable, with taxation carried only to the point where it does not weaken the will to work.

H. L. Lutz.—We may readily agree with the central idea of Professor Sprague's paper, namely, that the principle of "pay as you go" is a wise one to follow. In fact, we may go farther and say that this principle is deserving of much greater consideration than it is apparently receiving, in peace as well as in war. No principle of finance is being more widely or more flagrantly violated at the present time than that which requires a careful distinction between the purposes for which and the circumstances under which it is proper to borrow, and those which require the financing of the project under consideration by means of taxation.

Professor Sprague goes much farther than it has been customary to go, however, in his application of the idea that a larger part of the cost of war should be met by taxation, in proposing that the entire income of the community above that required to sustain the accustomed standard of living be appropriated for public purposes. This he sustains on three grounds.

In the first place, it would be entirely equitable, he argues, to equalize in this manner the contributions made by different classes of citizens to the total cost of the war. The "stay-at-homes" are to be compelled to make a heavy contribution from their income to offset the sacrifice, or risk of life and strength, made by those who are drafted for the armies. Universal compulsory military service is to be equalized by a levy of universal compulsory financial contributions. The ethical question here raised I do not care to discuss, but I do not think that the two sacrifices are comparable. Those who go to the front are still making far the greater sacrifice, and even such a scheme of taxation as here proposed would fall far short of equalizing the real sacrifice involved in military service in war time. We need not hesitate over the plan, therefore, on such grounds as these.

Professor Sprague assigns as the second ground for his proposal the argument that loans could thereby be dispensed with, and thus the advance of prices that would almost inevitably accompany the use of the customary financial measures might be avoided. The check upon consumption would be exerted rather by taxation than by rising prices, and the government would gain from the substitution of compulsory financial support for the voluntary aid vouchsafed through subscriptions to public loans or the acceptance of paper money. This advantage would be achieved by appropriating all income in excess of that required to maintain the customary standard of life of the ante-bellum period, and all excess profits gained during the war.

With regard to these arguments, it should be noted in the first place that if prices should advance during the war it would be more difficult to maintain the customary standard of living, and therefore the tax program could not be made as drastic as that which would be possible on the assumption that prices would not be materially affected. The question of the course of prices during a war thus becomes important. Professor Sprague has stated that there could hardly be a marked advance in the general price level without the expansion of credits which would accompany a borrowing policy, with the implication that if borrowing were not resorted to there would be no material general price advance. This appears to emphasize excessively the monetary factors in the determination of price. It seems quite certain to the present speaker that such a price advance might very well occur, indeed would almost certainly occur, even without an expansion of credits. The surrender by individuals of their purchasing power to the government, to be used for war purposes, would inevitably result in a wasting of resources, because the expenditure of this purchasing power would be absolutely unproductive. Professor Sprague has pointed out that a belligerent government is not deterred from purchasing by rising prices. So great is its necessity, in fact, that its use of materials must naturally outrun, during the war, the capacity of the country for replacement of the quantities consumed. This is the more true since the greatly increased government demand is accompanied by a heavy withdrawal of productive laborers from industry and a slackened rate of production of many necessary commodities. I am inclined to doubt, therefore, whether even the proposed program of war financing would result in preventing a general advance of prices, though I grant that this dislocation would probably not be as serious as if the other means of war financing were employed.

I have some question, too, of the fiscal adequacy of the plan as here proposed. If prices do remain stable, then incomes are not increased and the government's financial resource—the income of the community—does not enlarge, except through the appearance of excess profits made during the war. But without rising prices the excess profits will be smaller, if they appear at all. In order to yield sufficient revenue for modern war purposes, the government would almost certainly need to cut into the customary standard of life; and the addition of this proposal would, in my judgment, materially strengthen the plan from the fiscal standpoint.

The third ground for this proposal is that it would hasten the rehabilitation of the country after the conflict and permit a quicker readjustment to peace conditions and requirements, while it would diminish the handicap of a heavy war debt in preparing for possible future wars. This would doubtless be true, but against these advantages should be set the consideration, noted by Professor Sprague but not sufficiently emphasized, that the generation which is enduring the horrors of war might very possibly be more discontented, more difficult to unite in support of the national purposes, if it were asked to bear the whole financial burden, as well as the whole sacrifice of mental and physical agony. Much will depend upon the circumstances of the case. There is often a real justification for asking a future generation to bear a part of an extraordinary outlay, which is being incurred as much for the sake of posterity as for those now living. Thus borrowing, if used with proper caution, might serve to unite and solidify the people in the prosecution of the war, and it might also open up a financial resource to the government which would outweigh that of excessively drastic taxation. In practice, some combination of loans and taxes will probably always be used in emergency financiering, but—if I may close as I began—there is plenty of room, both in peace and in war-emergency financiering, for renewed emphasis upon the greater proportion of the cost that should in any event be borne by taxation.

Edmond E. Lincoln.—While giving my qualified endorsement to the general scheme of taxing incomes to meet war expenditures, as outlined by Professor Sprague, I wish to emphasize a certain aspect of the matter which he has merely suggested rather than developed.

In determining what war costs a country, in a financial sense, it is highly important to consider how much capital has been destroyed, how the remaining capital has been invested, and how rapidly new capital will be created at the close of the abnormal period. Indeed, I believe that the crux of the whole question is, What has happened to the concrete apparatus of production?

Under the usual method of financing war by means of loans, whether by bonds or by the issue of an unusual amount of paper money, there result not merely the improvidence and wasteful expenditure referred to in the paper, but also a great deal of unwise investment, careless management, and in many cases a failure to keep the productive apparatus in good repair. This seems to be a very significant consideration, for there is a wide margin, in most cases, between the *economically desirable* and the *absolutely necessary* expenditures for maintenance and repair—not to mention needed improvements. Without going into details, the reasons for this harmful policy are probably two, *psychological* and *economic*. In the first place, driven on by the reckless spirit of the times, by the eagerness to reap huge profits with little effort, those in control of industry will put less into the upkeep of their plants and will conduct their business with an eye to the present rather than the future. Secondly, the added cost of material and labor will act as a further deterrent.

Under a properly devised income tax, granting for the moment its political expediency and fiscal adequacy, it seems probable that the productive apparatus would be kept in a better state of repair. Not only would enterprisers be made to realize the gravity of the situation and the need for caution, but, moved by self-interest, they would doubtless make more ample provision for the upkeep of plant and would plan improvements for the future, realizing that otherwise the government would get most of their income, while it would be very difficult for them to recoup themselves at a later date. Though this policy, to be sure, might strike hard at the proposed plan as a means of raising revenue, such an objection is not necessarily conclusive, particularly when we give due weight to the fact that the economic motive involved would tend to shorten the duration of war. Furthermore, the savings of the people, however shrunken they may be, will be directed into channels ultimately more productive than could have been possible when everyone thought it his patriotic duty to invest in the government debt. And, finally, this *fiscally conservative,* though *politically radical,* method of financing would tend to steady prices, and so encourage still more the adequate maintenance of plant, and check speculation, not to mention other benefits gained.

Since, then, the scheme presented by Professor Sprague would seem to secure not merely the negative advantage of preventing luxurious consumption, but also the positive advantage of inducing a more conservative investment policy, as well as of promoting a higher conservation of the national productive apparatus and the national resources, its *desirability* is certainly esablished. Whether or not the canons of adequacy and expediency could be met is an open question.

T. K. URDAHL.—I have been greatly interested in Professor Sprague's accurate analysis of income and other taxes as a means of financing future wars. There is no criticism which can be made on his theoretical analysis. He is entirely right when he says that wars which are now financed largely by bond issues might, under ideal conditions, be equally well financed by direct and indirect taxation. If it had been possible to carry out such a scheme, it would probably have shortened many wars, and entirely prevented others. But there is no ministry in existence at the present time which would dare, under modern conditions, to take such a step. If they did attempt to finance by taxation, indirect taxes would probably have to bear an exceptionally large part of the burden.

As a matter of fact, Professor Sprague's theory is entirely contrary to the evolution of war finance during the past one hundred years. The tendency everywhere is to finance wars, to an increasing degree, by means of bonds, rather than taxes. The Napoleonic wars were financed by England to the extent of 53 per cent by bonds, and 47 per cent by taxes, the Crimean War was financed 57 per cent by bond issues, and 43 per cent by taxes. The Boer War, 69 per cent by bond issues, and 31 per cent by taxes, and in the first two years of the World War, in spite of the most strenuous efforts, England succeeded in raising only 14 per cent of the cost of the war by taxation; the remaining 86 per cent was raised by war loans.

Furthermore, it appears as if Professor Sprague has neglected a very important element of modern war finance—that of fiscal or governmental monopolies. Never, in all the history of the world, has there been such a powerful socializing force as the present war. In no era have governments ever attempted to establish so many and so powerful governmental monopolies as have the warring nations of today. It is reported from English sources that over 45 per cent of the wage-working classes of Germany are now working directly for the government. It is also reported that over 2,500,000 English wage earners are directly employed by the English government in its varied governmental war establishments. England has taken over the entire railway systems of England and Ireland. Russia and France have also taken charge of, and are at present operating, the bulk of their railway mileage. War necessities have forced these countries to employ efficient men in this branch of their war service. Russia has hired one of America's best known railway presidents to take charge of and reorganize her railway business.

War necessities have also forced these nations to purchase and sell not only to their military branches, but to the people at large, great quantities of goods designed for human consumption. England last year established a commission to buy all the sugar needed by the English people; and this commission has sold sugar throughout England at an average price of about eight cents a pound. In the same way, France and Italy have established a fiscal sugar-selling monopoly.

Recently these three commissions of the three countries above mentioned have combined to purchase their supply of sugar through a common purchasing agent. This is but an illustration of the innumerable monopolies of the same kind now operated by the governments of Europe.

A fiscal monopoly does not necessarily mean monopoly to manufacture and distribute or sell the entire product. It may be a monopoly for manufacture alone, or it may be exclusively a selling monopoly.

New Zealand and the other Australasian English dominions have gone even farther and established government abattoirs, government bakeshops, government mines, as well as governmental establishments for manufacturing all sorts of goods designed for military use.

It is probable, therefore, that in future wars, ministries will lay more stress on governmental monopolies than they have in the past, and that a very much larger part of the war's expense will be borne by governmental monopolies. In fact, it seems within the realm of possibility to assume that should another great war break out, one of the first things that the ministries involved will do will be to establish, on a very much larger scale than ever before, great governmental monopolies to carry on all kinds of enterprises which experience has demonstrated cannot readily be entrusted to competitive, privately-owned business. Such action will meet with less popular opposition than either direct or indirect taxes, since monopolies will be established, ostensibly, at least, to prevent rising prices as a result of war speculation in commodities needed by the masses. The large incidental revenue derived from them will not be generally regarded as burdensome and objectionable war taxes.

Professor Sprague.—The possibility of financing war by taxes rather than by loans, and the advantages to be gained by the adoption of that policy, do not depend upon any particular assumptions regarding the relation between money and prices. It matters not whether a rise of prices is caused by an increase in the purchasing media of a country, whether the increase is a concomitant of the rise of prices, or whether the increase in the purchasing media is a result of rising prices. Heavy war taxes would tend directly to reduce the volume of the purchasing media, not merely because borrowing from the banks and investments by banks in connection with war loans would be reduced. At the same time, by checking individual consumption the taxes would also reduce the civilian demand for commodities and set free labor for the production of military supplies.

It has been suggested that the general price level has no particular significance, but rather the price of a narrow range of particular commodities, those of prime necessity for military purposes. To this I am inclined in large measure to agree; but if unnecessary consumption at the outset of hostilities is reduced to a minimum, adequate supplies of these necessary articles can be more readily provided. Take coal, for example; much coal in the various warring countries would have been saved if passenger traffic had been reduced to a minimum, to say nothing of its consumption in the production and transportation of unnecessary articles of individual consumption. Similarly in the case of blankets and uniforms: nearly complete cessation of civilian purchases of clothes would unquestionably have contributed much labor for the production of adequate supplies of military clothing.

Whether the proposed rates of taxation would be sufficient to finance a war is indeed uncertain. Assuming no considerable advance in prices, a rate of 5 per cent on incomes of $1500, rising rapidly with higher incomes, together with heavy taxes on a few commodities entering into general consumption, would, I believe, be sufficient. It is to be noted that the taxes would be levied on all incomes and not as at present on incomes in excess of certain definite amounts.

In conclusion, I may say that all those to whom I have outlined the matter have without exception admitted that conscription of income is a just complement of compulsory service. The requirements of modern warfare in more than one direction are beyond comparison greater than those in former wars. In this country at the present time the necessity of universal military service is being urged. If no league of nations for the enforcement of peace can be established, the policy of compulsory service would seem to be essential for national safety. The acceptance of this unwelcome measure by the mass of the people will, I believe, be hastened if it is accompanied by proposals for adequately and justly financing the costs of war.